

## Message Text

UNCLASSIFIED

PAGE 01 LISBON 03706 301251Z

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ACTION EUR-25

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CIEP-03 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

COME-00 FRB-03 INR-11 NSAE-00 XMB-07 OPIC-12 LAB-06

SIL-01 SAM-01 PA-04 PRS-01 USIA-15 DRC-01 AGR-20

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R 301035Z AUG 74

FM AMEMBASSY LISBON

TO SECSTATE WASHDC 0379

INFO AMCONSUL OPORTO

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E.O. 11652: N/A

TAGS: EFIN, PO

SUBJ: IMPLEMENTATION OF PARTIAL TAX REFORM

REF: LISBON 3590

SUMMARY: IN ACCORDANCE WITH THE PROGRAM OF THE MFA AND THE PROVISIONAL GOVERNMENT WHICH PROMISES A WIDE-RANGING FISCAL REFORM, THE FIRST PHASE OF THAT REFORM WAS IMPLEMENTED ON AUGUST 20. RATES ON SEVERAL OF THE MAJOR TAXES, BOTH DIRECT AND INDIRECT, WERE REVISED. FULL FISCAL RFORM WAS PROMISED FOR THE FUTURE.  
END SUMMARY.

1. DECREE LAW 375 PROVIDING FOR A PARTIAL REFORM OF THE GOP TAX SYSTEM WAS PROMULGATD ON AUGUST 20. THE DECREE PREAMBLE DESCRIBED IT AS A FIRST STEP TOWARDS FULL FISCAL REFORM WHICH IS ONE OF THE HIGHEST PRIORITIES OF THE MFA AND THE PROVISIONAL GOVERNMENT. WHILE ADMITTEDLY A "MODEST" BEGINNING IT IS DESIGNED TO "CORRECT SOME OF THE MOST STRIKING DISTORTIONS" AND INITIATE A MORE EFFICIENT AND SIMPLIFIED TAX SYSTEM. IT IS EXPECTED TO  
UNCLASSIFIED

UNCLASSIFIED

PAGE 02 LISBON 03706 301251Z

"CONTRIBUTE SIGNIFICANTLY, ALTHOUGH STILL INSUFFICIENTLY", TO A

MORE EQUITABLE DISTRIBUTION OF THE TAX BURDEN.

2. IN EXPLAINING THE DECREE OVER NATIONWIDE TV, BUDGET SECRETARY ANTONIO COSTA LEAL EMPHASIZED THE NEW MEASURES WOULD BENEFIT THE LOWEST INCOME GROUPS AND NOTED THAT PERSONS WITH HIGHER INCOME LEVELS WOULD HAVE TO MAKE "GREATER FINANCIAL SACRIFICES." AMONG THE MAJOR BENEFITS TO THE POORER SECTORS ARE 1) HIGHER MINIMUM TAXABLE INCOME LEVELS ON THE INCOME (PROFESSIONAL) TAX WHICH WILL RELIEVE THE LOWEST INCOME EARNERS OF TAX LIABILITY; 2) LOWER INCOME TAX RATES FOR THE SECOND LOWEST INCOME GROUP; 3) INCREASED PERSONAL, DEPENDENT AND OTHER DEDUCTIONS FOR THE COMPLEMENTARY TAX; AND 4) INCREASED RURAL REAL ESTATE TAX EXEMPTIONS FOR PEASANT FARMERS. CONVERSELY, UPPER INCOME LEVELS WILL HAVE HIGHERS INCOME AND COMPLEMENTARY TAX RATES AND WILL PAY HIGHERS SALES TAXES ON LUXURY GOODS. THE SALES TAX ON ESSENTIAL GOODS WILL REMAIN UNCHANGED. THE DECREE ALSO PROVIDES MEASURES INTENDED TO HELP PREVENT URBAN LAND SPECULATION BY PROVIDING FOR A HEAVY TAX ON UNIMPROVED URBAN LOTS AND MEASURES TO ENCOURAGE AGRICULTURAL PRODUCTION BY TAXING UNUTILIZED FERTILE LAND. (SEE PARAGRAPH 5 FOR FURTHER DETAILS.)

3. THE GOP EXPECTS THE ABOVECOMBINATION OF MEASURES TO YIELD SOMEWHAT HIGHERS OVERALL TAX REVENUES, MUCH OF THE INCREASE COMING FROM INDIRECT (SALES AND STAMP) TAXES WHICH PROVIDE MORE THAN TWO-THIRDS OF TAX REVENUE. LEAL COSTA NOTED THAT PORTUGAL HAS ONE OF THE LIGHTEST TAX BURDENS (COLLECTIONS AS PERCENTAGE OF GDP) IN EUROPE AND HIGHER REVENUES ARE NEEDED TO REDISTRIBUTE INCOME THROUGHT THE PROVISION OF EXPANDED PUBLIC SERVICES. NO ESTIMATES OF THE TOTAL INCREASED TAX TAKE NOR THE BREAKDOWN AMONG TYPE OF TAXES ARE YET AVAILABLE.

4. BOTH THE DECREE PREAMBLE AND COSTA LEAL REPEATEDLY STRESSED THAT THESE MEASURES ARE ONLY THE FIRST PHASE OF OVERALL TAX REFORM. THE SECRETARY PROMISED FULL REFORM IN THE FUTURE WITH THE SECOND STEP TO COME WITHIN A FEW MONTHS. PHASE TWO, PRESENTLY UNDER STUDY BY A SPECIAL MINISTERIAL GROUP, MAY INCLUDE SIGNIFICANT REVISION OF BUSINESS (INDUSTRIAL) TAXES AND TAXES ON INCOME FROM BEARER INSTRUMENTS. IT WILL ATTEMPT TO CORRECT STILL EXISTING "DISTORTIONS". AND ADAPT THE TAX SYSTEM TO POLITICAL

UNCLASSIFIED

PAGE 03 LISBON 03706 301251Z

AND ECONOMIC DEVELOPMENT NEEDS. A SECOND STUDY GROUP HAS BEEN ESTABLISHED TO REFORM TAX ADMINISTRATION AND COLLECTION PROCEDURES IN ORDER TO REDUCE TAX EVASION.

5. SEVERAL OF THE MOST IMPORTANT TAXES HAVE BEEN REVISED. A BRIEF SKETCH OF THE CHANGES FOLLOWS.

A) PERSONAL INCOME TAX (PROFESSIONAL TAX

--THE MINIMUM INCOME FROM PERSONAL SERVICES SUBJECT TO INCOME

TAX LIABILITY IS INCREASED FROM DOLS 1200 TO DOLS 2000.

-- ON INCOME BETWEEN DOLS 2000 AND DOLS 4000 THE TAX RATE IS REDUCED-- BY 50 PERCENT AT THE DOLS 2800 INCOME LEVEL AND BY 33 PER CENT AT THE DOLS 3400 LEVEL.

--THE TAX RATE REMAINS UNCHANGED ON INCOME BETWEEN DOLS 4000 AND DOLS 14,000.

--THE TAX RATE IS SIGNIFICANTLY INCREASED ON INCOMES ABOVE DOLS 14,000--BY 12 PERCENT AT DOLS 16,000 AND BY 35 PERCENT AT DOLS 28,000.

B) COMPLEMENTARY TAX. (THIS IS A LEVY ON TOTAL INCOME FROM WHATEVER SOURCE, OVER AND ABOVE THE SEPARATE TAXES ON SPECIFIC INCOME SOURCES).

--TAX RATES AT INCOME LEVELS ABOVE DOLS 8000 ARE PROGRESSIVELY INCREASED.

-- DEDUCTIONS FOR DEPENDENTS HAVE BEEN RAISED BY 60 PERCENT.

C) SALES TAX

-- THE 7 PER CENT TAX ON ESSENTIAL PRODUCTS REMAINS UNCHANGED.

--THE 12 PERCENT TAX OF SEMI-LUXURY GOODS IS RAISED TO 25 PERCENT.

--SOME CHANGES ARE MADE IN THE COMPOSITION OF THE LISTS OF ESSENTIAL, SEMI-LUXURY, AND LUXURY GOODS TO PLACE A HEAVIER TAX ON THOSE GOODS PURCHASED BY UPPER INCOME LEVELS.

D) INTERNAL STAMP TAXES.

--THE COST OF OFFICIALLY STAMPED PAPER IS INCREASED.

--THE COST OF STAMPS TO CERTIFY AND LEGALIZE PERSONAL AND BUSINESS DOCUMENTS AND TRANSACTIONS IS INCREASED.

E) CORPORATION OR BUSINESS (INDUSTRIAL) TAXES.

--VERY SLIGHT CHANGES.

UNCLASSIFIED

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PAGE 04 LISBON 03706 301251Z

F) REAL ESTATE TAXES.

--THE MINIMUM TAXABLE RURAL REAL ESTATE VALUE IS RAISED FROM DOLS 4 TO DOLS 80.

--THE DECREE PERMITS TAXES IN SUCCESSIVE YEARS OF 25 PERCENT, 40 PER CENT AND 50 PERCENT ON NON-UTILIZED OR UNDER-UTILIZED FERTILE LAND.

--THE DECREE PERMITS TAXES IN SUCCESSIVE YEARS OF 20 PER CENT, 30 PER CENT AND 40 PER CENT ON URBAN LAND POTENTIALLY UTILIZABLE FOR BUILDING PURPOSES.

5. COMMENT: FOLLOWING THE PRIME MINISTER'S SPEECH ON THE ECONOMY AUGUST 22 (REFTEL 3590), THE DAM BLOCKING ECONOMIC LEGISLATION HAS BEEN AT LEAST PARTIALLY BREACHED. A STRIKE-LOCK-OUT LAW HAS BEEN PROMULGATED (SEPTEL) AND OTHER MEASURES (E.G., NATIONALIZATION OF BANKS OF ISSUE AND LABOR CONTRACTING) ARE REPORTEDLY

CLEARING LEGISLATIVE HURDLES. WHILE THE FISCAL REFORM LAW DESCRIBED ABOVE IS MODEST, IT IS A POSITIVE STEP WHICH THE GOVERNMENT CAN POINT TO. LIMITED REACTION TO DATE SUGGESTS THAT WITH THIS MEASURE THE GOVERNMENT HAS BEEN ABLE TO DEMONSTRATE ITS INTENTIONS TO IMPROVE THE LOT OF THOSE MOST DISADVANTAGED IN THE ECONOMY AND HAS DONE SO WITHOUT ALARMING THOSE AT THE HIGH END OF THE INCOME SCALE.  
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